

Employee Investment Advisory Council  
April 6, 2004 Recommendations  
457 Deferred Compensation Plan

**Recommendation #1:**

Adopt the Hotchkis & Wiley Mid Cap Value A fund to replace the Strong Opportunity Investors fund.

**Background:**

On March 9, 2004, the EIAC recommended that the Strong Opportunity Investors fund be discontinued because:

- 1) it had been on "Watch" for a year and
- 2) continued to fall below the benchmarks and guidelines established in the Investment Policy Statement.

Additionally, the Strong funds, in general, are being or have been investigated for alleged trading violations.

On March 25, 2004, the Board accepted the EIAC recommendation and authorized a manager search for a Strong Opportunity Investors replacement option.

**EIAC Rationale for Hotchkis & Wiley Mid Cap Value fund:**

Based upon manager search conducted by Arnerich, Massena & Associates, the Hotchkis & Wiley Mid Cap Value fund has:

- established track (performance) record over time
- established style and appropriate stock distribution and size
- high and consistent performance in both up and down markets

**EIAC vote: unanimous**

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**Board Motion:**

Option1: Accept the EIAC recommendation and adopt the Hotchkis & Wiley Mid Cap Value A fund to replace the Strong Opportunity Investors fund.

Option 2: Board choice

## **Recommendation #2:**

Drop the 5 Great West Profile Funds and negotiate with Great West for custom asset allocation fund using the EIAC and Board approved investment options (core options) as underlying funds.

## **Background:**

Based upon the Board's March 2002 directive to have 3 asset allocation funds in the 457 Plan, the EIAC, with the assistance of Arnerich, Massena & Associates, developed 3 custom asset allocation funds using the plan's core options as underlying funds. Custom asset allocation funds includes an additional record keeping charge by Great West Financial Services (GWFS).

Due to the additional GWFS cost and low utilization/participation in the Profile funds (<2%), in March 2003, the EIAC recommended that a survey be conducted prior to implementing custom asset allocation funds to determine:

- participant preference and possible use of asset allocation funds
- other information regarding participant behavior in the plan.

The Board initially approved the EIAC recommendation until the cost of a survey (conducted through the University of Montana) was known. The EIAC, consistently, has continued to express the desire and recommendation to conduct a statistically valid survey. They are not comfortable basing recommendations and decisions on information that may not be valid and reflective of the target population.

The EIAC's April 6, 2004 recommendation is:

- 1) attempting to meet the Board's directive of 3 asset allocation funds in the 457 plan.
- 2) addressing other concerns regarding the current GWFS Profile funds - especially in light of current mutual fund developments (i.e. scandals.)

## **EIAC Rationale for dropping the Profile Funds and building custom funds:**

A) Using GWFS Profile funds does not meet the Board's fiduciary responsibilities. It is not consistent with the Board's adopted Investment Policy Statement as all underlying funds in the GWFS Profile funds are not reviewed annually and evaluated against the benchmarks and guidelines in the Investment Policy Statement.

The Arnerich, Massena & Associate's evaluation of the GWFS Profile funds reveals significant questions regarding the underlying funds. For example, the GWFS Profile funds use Maxim, Invesco and Janus funds as some of the underlying funds. All three of these fund companies are under investigation for market-timing issues. The extent to which these funds are used, how GWFS reviews, evaluates and changes their underlying funds is not clearly known and, even when known, is not within the control of the Board. This illustrates the concern regarding the Board's fiduciary responsibilities and ability to exercise due diligence.

Custom asset allocation funds using the plan's core options will always ensure all investment options in the plan are under the Board's control and receive a consistent level of review using benchmarks and criteria established and adopted by the Board.

B) Custom asset allocation funds may be less confusing to participants as they would use fewer underlying funds and the underlying funds would be core funds already in the plan.

C) Brings plan into compliance with Board's directive.

D) Pulling the Profile funds may result in better ability to negotiate a better price with GWFS for recordkeeping the custom asset allocation funds.

**EIAC vote: 9 in favor; 2 opposed**

The two opposing EIAC members rationale was:

- 1) Need a plan in place for what to do with the <2% assets/participants using the current Profile funds if the funds are dropped. Will/may be a wake-up call though for GWFS regarding their custom funds funding.
- 2) If the Profile funds are dropped, the current GWFS price for custom funds doesn't make sense. The EIAC member does not want this as the only possible option because the Profile funds were dropped and asset allocation funds are needed.

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**Board Motion:**

Option1:      Accept the EIAC recommendation to drop the GWFS Profile funds and negotiate with GWFS for better pricing for custom asset allocation funds.

Option 2:      Board choice

### **Recommendation #3:**

Lower the administrative asset based fee charged to 457 deferred compensation plan participants as follows:

	CURRENT CHARGE	EIAC RECOMMENDATION DECREASED CHARGE
Flat Dollar Fee:	\$ 1.25 per quarter \$ 5.00 per year	No Change
Asset Based Fee:	(based on account balance)	(based on account balance)
(Up to) \$20,000	.45%	.35% ↓ .10%
(Next) \$20,001 - \$50,000	.35%	.25% ↓ .10%
(Next) \$50,001 - \$100,000	.20%	.15% ↓ .05%
(Next) \$100,000+	.00%	.00% - no change

### **Background:**

457 deferred compensation plan participants are charged an asset-based fee each quarter. The asset based fee covers all costs of administering the plan which includes: 1) Great West Financial Services (GWFS) contract fee; and 2) MPERA administrative costs. The asset-based fee is charged to participant accounts and collected by GWFS quarterly. After the fee is charged and collected, GWFS reconciles the collected fee to the contracted dollar fee. Fees collected in excess of the GWFS contracted dollar fee are submitted to MPERA and kept in a 457 admin trust fund. The funds in the 457 admin trust fund may only be used to pay reasonable expenses of the 457 plan.

Historically, the amount collected by the asset-based fee has exceeded the GWFS contract dollar fee and MPERA has received quarterly excess fees from GWFS. In 2000, the asset-based fee was lowered in an attempt to minimize the excess fees collected. At that time, there was some concern that, due to market correction and lower account balances, GWFS may not collect sufficient fees to meet their contract dollar fee. In that occurred, MPERA would use funds in the 457 admin trust fund to pay GWFS the contract amount. This concern has not proven true; the quarterly fees collected continues to exceed the contract dollar fee. Consequently, EIAC is recommends modifying the fee structure to a level that is projected to initially only cover GWFS contracted fees. **See attachment.**

### **EIAC Rationale:**

The proposed decreased fee structure reduces estimated annual surplus (excess fees) to an estimated \$2,550 and does not have excess or unnecessary charges assessed to plan participants. The 457 admin trust fund has sufficient assets to pay MPERA administrative costs and possibly conduct a survey to determine plan participant preferences and behaviors.

### **EIAC Vote: 10 in favor; 1 opposed**

The one opposing EIAC member felt that the new structure continues to have participants with higher account balances subsidize participants with lower account balances.

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### **Board Motion:**

Option1: Accept the EIAC recommendation to lower the asset-based fee to 457 plan participants as noted in above chart.

Option 2: Board choice